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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission
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IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, INC., DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS SUN CITY WEST WATER AND WASTEWATER DISTRICTS.	DOCKET NOS.: WS-01303A-02-0867 WS-01303A-02-0868 WS-01303A-02-0869 WS-01303A-02-0870 W-01303A-020908
AND RELATED MATTERS.	**YOUNGTOWN REPLY BRIEF**

The Town of Youngtown (Youngtown), by and through its attorneys undersigned, hereby responds to the positions presented by the Arizona-American Water Company, Inc. ("Company" or "Co."), the staff of the Arizona Corporation Commission ("Staff") and the Residential Utility Consumer Office ("RUCO"), Mr. Grimmelmann and the Arizona Utility Investors Association ("AUIA") in their closing briefs as they relate to the position advanced by Youngtown.

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I. “FAIR VALUE” DOES NOT EQUATE TO “REPLACEMENT COST”.

There is no dispute among the parties that the Arizona Corporation Commission (“Commission”) is required “to determine a fair value rate base [of the Company] before setting rates.” *U.S. West Communications v. Arizona Corp. Comm’n*, 201 Ariz. 242, 34 P.3d 351 (2001)(*U.S. West II*); Staff at p.2, ll. 13-23; RUCO at p.3, ll. 13-18; Co. at p.4, ll. 23-25; Youngtown at p. 6, ll. 7-17. The dispute is over how the Commission is to make that determination and how that determination is to be used in setting rates. The Company and AIUA assert a Fair Value Rate Base (“FVRB”) equivalent to the Reconstruction New Depreciated Rate Base (“RCRB”). All other parties, except Staff, assert the Company’s FVRB is equivalent to the Original Cost Less Depreciation Rate Base (“OCRB”). Staff advocates a FVRB that averages the OCRB and the RCRB.

The Arizona Supreme Court recognized in *Simms v. Round Valley Light & Power Co.*, 80 Ariz. 145, 151-54, 294 P.2d 378, 382-84 (1956) that “our constitution does not establish a formula for arriving at fair value. * * * No set rigid formula is required to be used. Only a reasonable judgment considering all relevant factors is required.” This truism has been recently affirmed in *US West II* (“only our jurisprudence requires this finding be plugged into a rigid formula as part of the rate-setting process”). *See also, Phelps Dodge v. Arizona Electric Cooperative, Inc.*, ___ Ariz. ___, ___ P.3d

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___, 2004 WL117253 (App. 2004)[1] The *Simms* court, however, distinguished between "fair value" ("the value of properties at the time of inquiry") that allows for increases and decreases in value, and "prudent investment" ("value at the time of investment") that does not. Despite recognizing the lack of any constitutionally-mandated formula to determine "fair value," the *Simms* court concluded the Commission could not use the prudent investment theory as a guide to establishing a rate base.

The Company expends much of its Closing Brief arguing that the prudent investment standard should not be used in this case. Yet not one party argued the prudent investment standard should be adopted by the Commission in this case. Instead, in rejecting the Company's use of RCRB as the FVRB, the parties argue that OCRB (or in Staff's case, an averaging of the OCRB and the RCRB) more appropriately reflects the Company's FVRB. Whether the use of the OCRB reaches a result similar to the prudent investment standard is irrelevant. Unlike *Simms*, no party is suggesting the Commission

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[1] *Phelps Dodge* first recognized: Our constitution requires the Commission to 'prescribe . . . just and reasonable rates and charges to be made and collected, by public service corporations for services rendered in the state'. *Ariz. Const. Art.* 15 §3. To assist the Commission in the 'proper discharge of its duties,' the Commission must 'ascertain the fair value of the property within the State of every public service corporation doing business therein.' *Ariz. Const. Art.* 15 §14 . . . The Commission has traditionally used fair value to set a utility's rate base. *Scates v. Arizona Corp. Comm'n*, 118 Ariz. 531, 534, 578 P.2d 612, 615 (App. 1978). Thereafter, the Commission applies a rate of return to the rate base in order to establish just and reasonable rates. *Phelps Dodge* at ¶ 18. Then citing *US West II*, the Court emphasized that "fair value should be considered in rate setting . . ., although the Commission has broad discretion in determining the weight to be given that factor in any particular case." *Id.* at ¶22.

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may ignore the RCRB testimony offered by the Company. They merely argue it should be given little or no weight because it is not reflective of the "fair value" of the plant at the time of inquiry.

Staff argues the Commission should, as it has done for years, average the OCRB and the RCRB to determine the FVRB. However, while the historical use of the data by the Commission may be considered by the Commission, it is not a compelling consideration in this case. Decision No. 63584 gave notice to the Company and its shareholders (and to its future ratepayers) that the Company's ability to book "the difference between the recorded book costs, less depreciation of Citizens' utility plant and assets and the purchase price negotiated between Citizens and Arizona-American" (i.e., the acquisition adjustment as defined by the Company at page 24 of its Closing Brief) for ratemaking purposes must be "based on Arizona-American's ability to demonstrate that clear, quantifiable and substantial net benefits have been realized by ratepayers, which would not have been realized had the transaction not occurred." Decision No. 63584 at 15-16. Therefore, when acquiring Citizens' assets, the Company and its shareholders could not reasonably expect the FVRB to be greater than the OCRB for ratemaking purposes unless and until the Company demonstrated "the clear, quantifiable and substantial net benefits" realized by ratepayers due to its acquisition of the property. The Company concedes it has made no such showing in this case.

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Therefore, the RCRB must be given little or no weight in establishing the FVRB in this case.[2]

The Company unabashedly equates the "purchase price," the "current value," the "RCRB value," and "fair value" of its plant. See Company's Closing Brief pp. 23-24 - where the Company states "the use of each district's RCRB as its fair value rate base is supported by the purchase price recently paid by Arizona-American for the water and wastewater systems and related assets owned by Citizens. .... The purchase price reflected the current value of Citizens' utility plant and assets. .... The fact that [the] purchase price . . . was substantially greater than the original or book costs . . . clearly establishes that the use of an OCRB to set rates in this proceeding would violate the fair value standard"[3]. As such, the Company at least implicitly advocates the use of the RCRB as the FVRB in order to secure ratemaking treatment similar to that which it might have obtained through an acquisition adjustment. This circumvention of Decision No. 63584 should not be condoned. The OCRB should be used as the FVRB as advocated by Youngtown and RUCO.[4]

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[2] Even Staff recommends that the Commission "<u>not give great weight</u> to reconstruction cost estimates." (STAFF, p. 2 - our emphasis)

[3] The Supreme Court rejected the purchase price as the sole measure of fair value in *Arizona Corp. Comm'n v. Arizona Water Company*, 85 Ariz. 198, 203, 335 P.2d 412, 415 (1959).

[4] Youngtown takes no position on which of the OCRB values presented by the parties is the more accurate. Youngtown notes that by accepting the OCRB as the FVRB, the Commission avoids the Company's challenge to the so-called "backing-in" methodology to setting rates.

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II. STAFF AND RUCO ADVOCATE A "JUST AND REASONABLE" REVENUE REQUIRMENT

The Commission's focus for a determination of its duties should be on the language in the Arizona Constitution and in the appellate decisions that interpret that duty, not on the out-of-state decisions cited by Company. The focus of Article 15, Section 3 is *just and reasonable* rates. This requires the rates to be fair both to the consumers and the utility. The revenue levels advocated by RUCO and by Staff meet this standard, while the revenue levels advocated by the Company do not.[5]

III. THE IRRIGATION TARIFF SHOULD BE EXPANDED

Youngtown intervened in this proceeding, *inter alia*, to request a slight expansion of the Company's interruptible irrigation tariff rate. The rate is currently available to certain customers in Sun City, but to no one else. Youngtown recommends the rate be expanded to allow governmental entities to receive reduced rates for certain existing uses that are open to all ratepayers. The focus of Youngtown's request is

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[5] While the revenue levels advocated be either Staff or RUCO will result in fair and reasonable rates for the Company, Youngtown cautions the Commission to avoid using a rationale in its decision that even appears to act in a manner rejected by *Simms* at 180 Ariz. 155 (i.e., first determining what the Company should be allowed to earn in order to pay a fair return on common equity and then "backing into" either the rate base or the return thereon). It is therefore respectfully suggested that the Commission either use the OCRB rate base as the FVRB (as advocated by Youngtown, RUCO and Mr. Grimmelmann) or expressly find the revenue requirement derived by multiplying the weighted cost of capital by any FVRB greater than the OCRB to be unreasonable and unjust.

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Maricopa Lake, a small residential lake created in 1955 and having only 2.8 surface acres.

In its Closing Brief, Staff opposes the change solely because "it will shift cost to residential consumers." STAFF at p. 20. This argument ignores the fact that the lake is an amenity available to the residential customers. Staff has not demonstrated that the requested change in the tariff would cause any appreciable shift in revenues or that the additional revenues would fall predominantly on the residential class. Since the residential minimums and first rate tier will be unchanged by this shift, the responsibility will fall on larger water users in any event. Moreover, the Staff has conceded that the limited access to the present tariff is discriminatory (Dennis Rogers at TR VI p. 1128-1129). The recent *Phelps Dodge* decision, *supra,* reaffirms the judiciary's intent to enforce constitutional and statutory provisions regarding discriminatory practices in the "rates charged for rendering a like and contemporaneous service." *Id* at ¶22.

It is reasonable to provide a price break for certain municipal activities as a matter of public policy. It is also reasonable to provide a price break for accepting service on an interruptible basis, as is the case with this tariff. For these reasons, Youngtown respectfully requests that its proposal to expand the irrigation tariff be approved by the Commission.

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IV. RATE DESIGN

Youngtown did not, and could not afford to, prepare and present evidence on the cost of service or a new rate design. Mr. Burton, however, did testify that rate redesign should not accompany a significant increase in rates (TR VII, pp. 1298-1300). Alternatively, he suggested that the rate design be examined separately, after a revenue level has been set. Finally, he opposed the Staff's proposed rate design as having too significant a break in the tiers and therefore penalizing persons rather than encouraging water conservation (TR VII, pp. 1301-1302). For these reasons, Mr. Burton advocated spreading the rate increase evenly across the existing rates as proposed by the Company. However, if the Commission is inclined to adopt a new rate design, Youngtown requests that the rate design issue be dealt with after the revenue level is established. In this manner, the late filed rate design proposed by the Company can be compared and contrasted with Staff's rate design on the actual approved rates. Moreover, the additional impacts on particular customers could be delayed and implemented only after providing some notice to afford those customers an opportunity to proactively prepare for the new rate design. Finally this will send a clearer price signal than if it is combined with a general rate increase.[6]

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[6] Youngtown recognizes ALJ Wolfe, by Procedural Order dated February 11, 2004, ordered parties wishing to respond to the inverted-block rate design schedule submitted by Arizona American to do so in their February 18, 2004, closing briefs. While Arizona-American had provided a draft of its inverted-block rate prior to the formal filing on February 4, 2004, Youngtown has had insufficient time to decide whether to budget

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V. CONCLUSION

Based on the foregoing, Youngtown's Opening Brief and the testimony presented at hearing, Youngtown respectfully requests the Commission adopt the following:

1. Utilize the Original Cost Less Depreciation Rate Base for the Company's Fair Value Rate Base;

2. Revise the Irrigation Water Rate Tariff to include certain existing municipal water uses, and in particular Maricopa Lake;

3. Implement rate increases in a gradual fashion if the rate increase exceeds 20%;

4. Amortize the allowed rate case expense over a five-year period; and

5. Defer any rate redesign until the next rate case or to a proceeding to follow setting the new revenue level.

RESPECTFULLY SUBMITTED this 18th day of February, 2004.

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funds for this undertaking, let alone make an analysis of the rates. Moreover, the impact on particular customers between Staff's proposed rate design and the Company's proposed rate design will differ significantly depending on the revenue requirement authorized by the Commission. These factors also justify delaying action on altering the rate design until a later date.

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